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SUBJECT: UKRAINE TRADE DEFICIT SHRINKS IN H1 2009

REF: KYIV 1086

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¶1. (U) Summary and comment: Recently released government of Ukraine (GOU) statistics show the trade deficit narrowing 93% in the first half of 2009, with exports falling by 46.8% and imports by 53.4%. The government reported that the hardest hit import sector continues to be automotive, declining 89.9% in the first half of the year. Imports are expected to pick up in the second half of the year due to increased gas purchases. How much imports outpace exports in the months to come will depend as much on external demand for Ukraine's commodities as it will on the domestic appetite for consumption. End summary and comment.

Trade Deficit Narrowed on Low Imports

¶2. (U) Ukraine's trade deficit narrowed 93% year-on-year (yoy) in the first half of 2009 from $7.07 billion to $472 million. Although exports fell 46.8%, imports fell even more sharply at 53.4% yoy. Imports of machinery and vehicles showed particularly strong declines: 65.1% and 89.9%, respectively. Imports have suffered from hryvnia depreciation, import restrictions, and falling domestic demand. In coming months, analysts expect this trend to reverse and the trade deficit to widen somewhat. Resumed growth in energy prices and expected larger volumes of natural gas imports, along with the need to replenish inventories that have not been restocked due to the crisis and ensuing credit crunch, should push up imports in the second half. However, the rate of export decline is also likely to slow as the global economy shows signs of improvement and demand for Ukraine's steel and other commodities improves.

Case Study: Autos -- Hardest Hit Import Sector
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¶3. (SBU) Representing almost 14% by value of Ukraine's merchandise imports in mid-2008 and only about 5% now, the automobile import sector has suffered significantly from the economic downturn. Car dealers have been forced to sell goods far below cost to maintain cash flows and meet payroll. One foreign car importer commented to us on August 29 that he expected to lose $5 million in 2009. He said that his company had met its foreign financial obligations in the year to date, only because it had been willing to take short-term losses and shed costly inventory. Other car companies that had not taken the same measures, he said, still had a glut of unsold inventory and could not make advanced orders for 2010 product. The fact that some importers were making plans to build new inventory, while others remained stuck with 2009 models, would continue to undermine import growth for the remainder of 2009, he said.

¶4. (SBU) The car importer also told us that premium brand vehicles, such as Porsche, had maintained their popularity during the crisis,

though more than 60% of such vehicles had been illegally imported in 2009, far higher than the 20% tacitly allowed by the government in previous years. The dealer cited heightened corruption among border and customs officials, who, he said, were signing falsified documents in the absence of other profit opportunities.

¶5. (SBU) The GOU's 13% import tariff surcharge on automobiles had not dramatically reduced car imports, given that thousands of unsold 2009 vehicles had been ordered before the crisis and remained for months in open lots on the periphery of Ukraine's major cities, according to the car importer. Now that many inventories had been lowered, with sales of vehicles at or below cost, some car importers were preparing to bring new stock into the country. Unsure whether to trust the August 3 statement of Deputy Minister of Economy Valeriy Pyatnytskiy that the 13% tariff surcharge would not extend beyond its expiration date on September 7 (reftel), importers were lining up cars at staging areas near Ukraine's border crossings, from which they planned to bring vehicles into Ukraine in a single bold rush at the end of the week.

Credit Crunch Mitigated by Rollovers

¶6. (SBU) Importers have told us that dollar or euro-denominated external loan obligations caused the biggest drag on foreign trade in 2009, due to a 40% currency devaluation and the closure of international financial markets to Ukrainian borrowers. Nonetheless, most short-term loans were refinanced with local banks in the first half of the year, according to the National Bank of Ukraine (NBU). The overall roll-over rate for commercial loans in the first seven months of 2009 was 79 percent. Despite the fact that commercial bankers have complained to us that they were "over a barrel" with potential non-performing loans held by both exporters

and importers, the NBU has touted the fact that corporations were able to roll over roughly 99% of their obligations through July.

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